

Background

Net56 is a small, privately-owned technology solutions provider. Net56 began participating in the E-rate program in 2003 in response to local school districts' interest in more personalized, responsive services that are tailored to their rapidly changing needs. Currently, Net56 provides e-rate and non e-rate services to eight school districts in northern Illinois, including the Harrison School District, the recipient of the services which are the subject of this appeal (the "District"). The District is comprised of a single school with 480 students in the pre-kindergarten through 8th grades. More than 30% of the students are eligible for the National School Lunch Program. As a result, the District is eligible to receive services under the E-rate program at the 60% discount level.

Net56 began providing e-rate services to the District in funding year 2007. USAC reviewed and approved a Form 471 funding request from the District for Net56 services for funding year 2007 that is substantially similar to the services at issue in this appeal.⁵ Several months into the 2008 funding year, however, USAC advised Net56 and the District that it was conducting a special compliance review of the funding applications filed by school districts served by Net56 and that all funding for these districts would be placed on hold, including funding that had already been reviewed and approved by USAC. USAC did not supply Net56 or the District with any information on the reason for the compliance review.

On December 27, 2007, the District posted a Form 470 for the 2008 funding year on the USAC website, initiating a 28-day competitive bidding period and seeking bids for Internet access, web and email hosting, firewall, and wide area network services.⁶ In response to the Form 470, Net56 proposed a written offer with specific proposed rates for each of these services

⁵ See 2007 Form 471 Application Number 552545.

⁶ See FCC Form 470 Application Number 325210000655382, attached hereto as Exhibit E (the "District's Form 470").

to the District for e-rate services for the 2008 funding year. The District accepted Net56's bid and signed the quotation on February 3, 2008, thereby entering into a contract ("2008-09 E-Rate Contract"). On February 7, 2008, the District filed a Form 471 with USAC, requesting funding for the e-rate services to be provided by Net56 pursuant to this contract.⁷

On February 23, 2010 – more than two years after the Form 471 was submitted – USAC finally issued a FCDL. The FCDL denied funding for each of the FRNs and stated, "[t]his funding request is denied as a result of the program violations explained in the Further Explanation of Administrator's Funding Decision letter sent this date under separate cover."⁸ In fact, the District and Net56 had to wait another month, until March 26, 2010, to receive the letter from USAC describing the reasons for the funding denial. Shortly thereafter, on April 23, 2010, Net56 filed the Letter of Appeal to USAC, appealing the February 23, 2010 funding decision. On August 4, 2010, USAC issued the Administrator's Decision, denying Net56's appeal and upholding its decision to deny all funding for the FRNs covered by the District's Form 471.⁹

I. The Administrator's Decision Erroneously Ignores the Right Contract.

USAC's stated basis for denying all funding for the FRNs is its determination that the District and Net56 "failed to provide a breakdown of the eligible versus ineligible services being received from Net56 and their respective dollar amounts..."¹⁰ As Net56 explained in the Letter of Appeal to USAC, this conclusion was based upon review of the wrong contract.¹¹ In the course of USAC's special compliance review of Net56, the District provided USAC with a copy of a 60-month term Master Services Agreement, dated June 21, 2007, between Net56 and the

⁷ See Exhibit D.

⁸ FCDL at 3-6.

⁹ Administrator's Decision at 1.

¹⁰ Further Explanation Letter at 6.

¹¹ Letter of Appeal to USAC at 2-3.

District (“MSA”).¹² The MSA provided a foundation for a relationship between Net56 and the District upon which the District could later choose to contract for specific services. USAC instead incorrectly understood this agreement to be “the contract” for the provision of e-rate services for the 2008 funding year. Since the 2007 MSA document does not provide any breakdown of e-rate eligible and ineligible services and their respective costs, USAC denied the District’s funding request on the basis that this breakdown was missing.

But that breakdown is plainly included in the parties’ 2008-09 E-Rate Contract, which is the document that the parties agreed to and executed during the bid period. This contract clearly describes and states the separate monthly price of each eligible e-rate service, distinct from all ineligible services. As such, the 2008-09 E-Rate Contract satisfied the requirement that USAC erroneously found to have been violated, by allocating eligible and ineligible services and their respective costs.

USAC nonetheless decided that the MSA was the only contract because the District had in one instance referenced the MSA in responding to a USAC question regarding the applicable contract. Nothing in the Commission’s rules directs USAC to deny funding on the basis of a minor error in responding to USAC inquiries when in reality the parties complied with program rules. Here, the 2008-09 E-Rate Contract obviously applies. If the District and Net56 had believed the 2007 MSA was a contract for e-rate services for funding year 2008-09, the District would have had no need to seek bids at the end of 2007 through a new Form 470, and Net56 would have had no need to provide a new quotation.¹³ Moreover, even if the MSA included e-rate services for 2008, which it does not, it would have been superseded by the subsequent

¹² The Further Explanation Letter states that this MSA was signed on June 21, 2006, but it was signed on June 21, 2007.

¹³ The term of the MSA is 60 months, into 2011.

agreement executed after the District posted its Form 470 for 2008.¹⁴ Therefore, the 2008-09 E-Rate Contract signed on February 3, 2008 is the relevant contract between Net56 and this contract clearly allocates and states the price for each e-rate service covered by the District's Form 471.

In any event, USAC's conclusion proves too much. USAC states that the [2008-09 E-Rate Contract] "is not a separate contract but rather part of the [MSA]." But if the 2008-09 E-Rate Contract is part of the MSA that USAC believes is the contract, then that contract *includes* the allocation between eligible and ineligible services that USAC stated was missing. Whether the quotation is a separate contract, as Net56 and the District believed, or whether it was incorporated into the MSA prior to the Form 471 filing, as USAC apparently believes, either way it was contractually agreed to by Net56 and the District during the bid period, and either way it thereby set a clear allocation between eligible and ineligible services. Nothing in the Administrator's Decision alleges any flaw in the 2008-09 E-Rate Contract; instead, its decision is based on the supposition that that agreement simply does not apply, when in fact it does.

II. The District Paid for E-Rate Services

Unlike Net56's prior appeal, filed with the Commission on August 30, 2010, in this case USAC also asserts that funding should be denied because it thought that the District did not pay for eligible services. USAC made that finding because the District's payments for 2008 were delivered to a leasing company in the amount that was originally established by the lease agreement attached to the 2007 MSA. USAC apparently concluded that this payment must be solely attributed to the ineligible equipment described in the lease agreement between the

¹⁴ The Administrator's Decision notes that Exhibit C, Section 2 of the MSA casually makes reference to E-Rate. However, no e-rate services were actually contracted for by the MSA as signed in 2007, and so these stray references do not render the MSA to be the e-rate contract, rather than the actual 2008-09 E-Rate Contract that was entered during the bid period.

District and the leasing company, and not to the eligible services provided under the parties subsequent E-Rate Contract.

It is true that the lease agreement originally described a payment of \$7377.25 without reference to allocation of any part of that payment for Net56 services (eligible or ineligible). However, the District and the leasing company subsequently agreed in writing (to reflect their original intent) that the equipment was not worth this amount and that a portion of the lease payment would be provided by the leasing company to Net56 for services. The District and Net56 also agreed in writing to a service-by-service allocation of these funds to eligible and ineligible services. These documents are included in Attachments 3 and 4 to Net56's Letter of Appeal to USAC. USAC did not dispute that these payments were made by the District or that Net56 received them from the leasing company. However, USAC chose to ignore the parties' allocation of the lease payments because the allocation document between the District and the leasing company stated that "This clarification does not amend the terms of the Master Lease."¹⁵ USAC therefore stuck with its position that the MSA is the only contract, that the MSA provided only for a lease payment that is only for equipment, and that the District therefore only paid for equipment and not eligible services.

USAC's position should be reversed because it does not comport with reality. *USAC has not disputed that the leasing company did in fact transfer a portion of these funds that it received from the District to Net56.* USAC also did not dispute that that the amount of the District's funds transferred to Net56 were more than enough to pay the District's non-discounted share of eligible services. If the payments were made solely for equipment owned by the leasing

¹⁵ Although Net56 cannot speak for the District or the leasing company, the parties presumably meant that they did not view this clarification as an amendment because it did not change the overall payment that would be made by the District. It would be absurd to read this document, as USAC does, and yet conclude that the leasing company and district nonetheless continued to believe that the lease payment was solely for equipment.

company, then it would not have delivered the funds to Net56. Instead, the leasing company did pay Net56 on behalf of the District both for eligible and ineligible services, in accordance with the exact allocations specified by Net56 and the District in Attachment 4 of the Letter of Appeal and in their 2008-09 E-Rate Contract. It is incorrect and exceedingly unfair for USAC to ignore these payments, which were actually made, on the sole basis that USAC reads the lease agreement to mean something other than what the parties expressly clarified it to mean. USAC's basis is especially inappropriate given that the lease agreement is not the applicable contract for e-rate services.

Net56 now recognizes that the District's payment for e-rate services through the leasing company was confusing to USAC, and it has therefore moved away from that model. But the fact is that the District did make payments that cover its non-discounted share, and these payments were received and retained by Net56 as the e-rate services provider, and not by the leasing company for equipment that it owned. The Administrator's Decision was therefore incorrect in concluding that the District had not paid for eligible services.

III. USAC's All-or-Nothing Implementation of the Cost-Effectiveness Rule is Inequitable.

If the Commission agrees with the position set forth above, then it should direct USAC to provide full funding for the Internet Access services provided under FRN 1753187. However, in the case of WAN, firewall, email and web hosting services covered under FRNs 1753238, 1753268 and 1753317, USAC indicated a belief that these services were not cost-effective and denied funding for those FRNs.¹⁶ In the Letter of Appeal to USAC, Net56 asked USAC to reconsider that decision to the limited extent necessary to modify the FCDL to grant funding in the amount that USAC did conclude would have been cost-effective. The Commission

¹⁶ Further Explanation Letter at 1-5.

previously instructed USAC that even when an applicant violates the cost-effectiveness rule, it is still entitled to funding in the amount associated with the least expensive cost-effective service.¹⁷ In the *Macomb Order*, the school district received identical services from multiple service providers, including the lowest-cost bidder and two providers who offered the service at a higher price. USAC determined that the Macomb district violated the Commission's cost-effectiveness rule by not selecting the lowest-cost bidder to provide all of the services and denied the entire funding request on the basis that more than 30 percent of the request was ineligible. In its decision on appeal, the Commission found that USAC should not have denied all funding even though it agreed with USAC's determination that the school district violated program rules by not selecting the most cost-effective service offering.¹⁸ The Commission recognized that it would be unnecessarily unfair to deprive an applicant or service provider of all funding for an eligible service based upon an all-or-nothing approach.

In the Administrator's Decision, USAC denied the appeal regarding cost-effectiveness because Net56 was the only bidder and its bid was found to not be cost-effective. "USAC cannot honor your request to approve funding up to the amount that is found to be cost effective because doing so would constitute a change in price and after the close of the bidding process as such price changes and renegotiation of the contract would constitute a violation of the FCC competitive bidding rules."¹⁹ This is nonsense. Net56 is simply asking to be able to receive at least a fraction of the contract price for a service that no one denies has already been provided in full. This is not a "renegotiation" that Net56 has requested *from the District*; it is a request for a

¹⁷ See Letter of Appeal to USAC at 4, citing *Request for Review by Macomb Intermediate School District Technology Consortium*, File no. SLD-44190, Order, FCC 07-64 (rel. May 8, 2007) (the "Macomb Order").

¹⁸ Macomb Order at paras. 6-9.

¹⁹ Administrator's Decision at 3-4.

shred of equity *from USAC*. As such, it is not a renegotiation with the District any more so than it would have been in the *Macomb* case.

Net56 understands from USAC staff that its all-or-nothing approach reflects its belief that the Commission does not want to put USAC into the position of having to determine a cost-effective rate to award. However, USAC necessarily must determine at least an estimate of cost-effectiveness in order to apply the Ysleta test to find that a service is not cost-effective. The Administrator's Decision in fact specifically quotes rates it believes that it would have found to be cost-effective. No greater effort would have been required to provide funding in these amounts. It may well not always be a fair amount, but it would always be fairer than denying funding altogether.

For these reasons, the Commission should remand the cost-effectiveness decision to USAC and direct it to grant funding for FRNs 1753238, 1753268 and 1753317 in the amounts that USAC determined would have been cost-effective.

IV. Is Would be Inequitable to Deny All Funding

Even if the Commission finds that the District and/or Net56 failed to comply with some technical element of program rules, the Commission should give substantial consideration to the inequities that have been imposed on Net56 in this case as a result of USAC's extremely slow decision-making process. The delay in issuance of the FCDL unreasonably prejudiced Net56 and the District. Net56 initially contacted USAC in February 2006 to try to determine if its proposed contract structure was acceptable, and it walked away from those discussions believing that it had been given a go-ahead. USAC then later confirmed Net56's impression by providing funding for the District and other districts using the same approach with Net56 for subsequent funding years. USAC apparently decided sometime in 2008 that it had concerns with Net56's

approach, but until the FCDLs in 2010 it would never clearly articulate to Net56 what those concerns were. Once USAC notified Net56 that it was conducting a special review of the applications of the school districts served by Net56, both Net56 and its counsel repeatedly called and wrote to USAC, begging to be told the details of any concerns so that Net56 could address them before contracts were submitted for the following school years, to no avail. In writing and in person, Net56 made clear that it was available at any time to work with USAC to provide any information or clarification that USAC needed to complete its review and issue a decision.²⁰ During this time, Net56 and the District could have incorporated guidance from USAC into their approach to funding year 2009-10, and later funding year 2010-11, so that there would have been no problems with those applications. But USAC kept the District and Net56 in the dark until it was too late.

As the Commission has noted, “the timing of the Commission’s and USAC’s processes may be critical to schools and libraries. Lengthy intervals for processing or reviewing applications could have a disruptive effect on the budget or procurement schedule for schools or libraries.”²¹ In *Request for Review of Totowa Borough Public Schools*, the Wireline Competition Bureau found that USAC “erred by unreasonably delaying its notification to Totowa of the problems with its Form 470” for eight months.²² More recently, the Bureau addressed a scenario

²⁰ See, e.g., letter from Paul Hudson to Mel Blackwell, dated October 16, 2009, attached hereto as Exhibit F.

²¹ *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, WC Docket No. 05-195, 20 FCC Rcd 11308, 11321, ¶ 29 (2005). In the same NPRM/FNPRM, the Commission reiterated that such delays and the resultant impact on mandated budget or procurement schedules “can have a significant negative impact on schools’ and libraries’ ability to achieve connectivity goals.” See *id.* at 11325, ¶ 38.

²² *Request for Review by Totowa Borough Public Schools, Schools and Libraries Universal Service Support Mechanism*, Order, File No. SLD-265823, CC Docket No. 02-6, DA 04-3898, ¶ 4 and n.14 (Wireline Comp. Bur. 2004) (citing previous instances of unreasonable or excessive delay). See also *Request for Waiver by Lettie W. Jensen Library, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, Order, File No. SLD-267950, CC Docket Nos. 96-45 and 97-21, DA 01-2401, ¶¶ 5-7 (Com. Car. Bur. 2001) (holding that a two-month delay in notification regarding an omitted signature was unreasonable); *Request for Waiver by Council Bluffs Community Schools, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, Order, File No.

in which an applicant's numerous communications with USAC were ignored, ruling in favor of the applicant and pointing to the applicant's "several attempts to follow-up with USAC, and USAC's delay in responding."²³ A common theme in these cases is that dispensation should be provided to applicants when unreasonable delays by USAC inflicted prejudicial harm.

There is no dispute that Net56 in fact provided valuable, eligible services to the District. There is no dispute that during the competitive bidding period, Net56 quoted specific rates to the District for each eligible service, and that the District signed that proposed contract. There is also no dispute as to the amounts billed and paid for each eligible service – indeed, USAC's Further Explanation Letter even references the rate for each separate service in discussing their cost-effectiveness. (Thus, USAC on the one hand cites the exact rates from the 2008-09 E-Rate Contract while on the other hand perplexingly claiming that these rates have not been identified by being separately allocated.) There is no dispute that the Internet Access services were provided at cost-effective rates. There is no dispute that the District properly sought competitive bids, or that Net56 was the best offer available to the District. USAC's only basis for denying all funding is that the District and Net56 supposedly failed to clearly allocate prices between eligible and ineligible services – even though they timely executed contract terms that did exactly that.

Under all of these circumstances, USAC's denial of every cent of requested funding elevates form over substance and unfairly penalizes the District and Net56 for USAC's extremely slow process. The Commission should therefore grant Net56's appeal of the Administrator's Decision and the underlying funding decision and remand the District's 2008 funding application to USAC for approval.

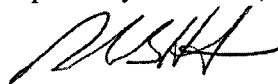
SLD-E007282, CC Docket Nos. 96-45 and 97-21, DA 00-1909, ¶ 4 (Com. Car. Bur. 2000) (determining that a failure to post applicant's Form 470 for approximately six weeks was excessive).

²³ *Request for Review by Bradford Regional Medical Center; Rural Health Care Universal Service Support Mechanism*, Order, File No. RHCP 14491, WC Docket No. 02-60, 25 FCC Rcd 7221, 7223, ¶ 4 (Wireline Comp. Bur. 2010).

Conclusion

For the foregoing reasons, the Commission should grant Net56's appeal of the Administrator's Decision and the underlying funding decision and remand the District's 2008 funding application to USAC for approval.

Respectfully submitted,



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October 4, 2010

CERTIFICATE OF SERVICE

I, Debra Sloan, hereby certify that a true and correct copy of the foregoing *Request For Review By Net56, Inc. of Decisions of The Universal Service Administrator* was mailed postage prepaid this 4th day of October to the following:

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/s/ Debra Sloan

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